Independent Directors Council
Promoting Excellence in Fund Governance

1998 General Membership Meeting: Chairman’s Report

ICI Chairman’s Report at the 1998 General Membership Meeting

by

Don Powell

Chairman, Investment Company Institute

May 14, 1998

Thank you, Paul, for that warm and kind introduction. Thanks also for putting together such an outstanding conference program. And let me add my welcome to our members and guests of the 1998 General Membership Meeting. Since our last annual meeting, we can be proud that the Institute has continued its tradition of leadership.

Let me begin by reviewing industry developments during the past year, and try to put those developments into perspective. And then I want to discuss the simple principle that is fundamental to our continued success as an industry. That principle is trust.

First some perspective.

Since we last met one year ago, our industry has continued to grow and diversify. And, as always, the mutual fund industry has remained highly competitive.

Against a backdrop of highly positive economic signals, the assets of our nation’s 66 million mutual fund shareholders grew in 1997 by $942 billion to $4.5 trillion in about 6,800 funds. Overall, the year’s 27 percent asset growth was quite good, but it was not a record for our industry.

Last year’s growth was fueled more by performance than by cash flow, although new cash flow of $272 billion into long-term mutual funds topped the previous record of $242 billion in 1993.

The continuing trend is for individuals to sell their individual stock holdings in favor of diversified long-term holdings in mutual funds. Federal Reserve data indicate that 1997 was the fourth consecutive year in which households were net sellers of directly held equities, with those sales exceeding flows into mutual funds. This might help answer those who contend that the mutual fund industry has played the lead role in the market's seemingly endless climb.

Assets in equity funds increased 37 percent in 1997 to $2.4 trillion. Still, stock mutual funds hold only 19 percent of the $10.9 trillion total of outstanding stocks of domestic corporations, while individuals are the largest direct holders of individual stocks, accounting for about half of the total.

Investment for retirement is a major trend supporting inflows into stock funds. Retirement plans accounted for about 25 percent of inflow into equity funds in 1996, the latest year for which data is available. Systematic investing in retirement plans and other automatic investment plans also help explain why stock market prices do not move with inflows to stock funds.

Declining interest rates in 1997 boosted bond fund performance. For the year, bond fund assets grew by $143 billion, or 16 percent. Bond funds by the end of 1997 accounted for $1 trillion, or 23 percent, of total mutual fund assets. Net new cash flow to bond funds was $45 billion, the highest level since 1993's record inflow of $113 billion.

Money market funds have continued to grow and gained 17 percent last year to top the $1 trillion mark. Assets of taxable money market funds reached $898 billion last year, while tax-exempt funds totaled $161 billion. Overall, money market fund assets rose by $157 billion and represent about 24 percent of the industry's total assets.

Our industry remains highly competitive despite the large numbers of mergers involving fund management companies. In fact, the concentration of industry assets among the largest fund management companies has decreased since 1990. Last year, the five largest fund organizations held 34 percent of all industry assets, down from 36 percent in 1990.

Today, our industry serves nearly 66 million individuals. That is 37 percent of American households. The typical mutual fund shareholder is 44 years old and has a household income of $60,000. Mutual fund shareholders are mostly middle class and middle age and are investing primarily for retirement.

And now, more than ever, they have an unquenchable thirst for knowledge about financial markets, products and services. Which brings us to the theme of our meeting—Building Investor Knowledge.

As Paul Haaga pointed out, this is more than a theme. It is the cornerstone of all that we do. It is imperative that each of us commit ourselves to this industry effort. During the CEO panel at our Keynote Session later this morning, you will have an opportunity to hear how important building investor knowledge is to our industry, particularly in developing realistic shareholder expectations.

Never before has our society seen such an explosion of information. We are, indeed, living in the information age. And much of that information is financial.

Ours is a world of 24-hour television business news channels and a proliferation of personal finance publications, wire services, newsletters and newspapers. The clang of the market's closing bell rings out nightly on the evening news. There are television cameras broadcasting from the floor of the New York Stock Exchange. And then there's the Internet, which has the power to bring a world's worth of information to your desktop, laptop or wherever else you happen to be.

It is in this world that each of us sees the key to our futures. That key, I believe, is understanding the fine line that separates information from knowledge.

One way to think of this difference is to imagine two books on a shelf. Both are filled with words. One is a dictionary, a marvelous source of information. The other book is an encyclopedia. Using the same words, the encyclopedia offers more than information. It offers knowledge.

In today's seemingly frenzied marketplace of information, mutual funds must be the trusted sources of information and knowledge for our shareholders.

We do this by:

- Continuing to speak with one single clear voice as an industry;
- Communicating openly, honestly and understandably with our shareholders about the risks, as well as the rewards, of their investments;
- Educating existing shareholders, as well as future generations of investors, about the importance of planning and saving for secure retirements and other long-term goals;
- Working to harness investor expectations, particularly in times such as these with the market hitting record highs;
- Training our employees to better understand the increasingly sophisticated needs of shareholders;
- Investing in technology to help meet the challenges of the future;
- Holding all members of our industry to the highest fiduciary standards consistent with our tradition of integrity.

What it all comes down to is trust.

As Matt will tell you in a few minutes, the success our industry has enjoyed over the years is tied directly to the confidence the investing public has placed in us. Confidence can be defined as faith or trust in a person or thing. Faith is a belief in the truth or trustworthiness of something. But what is trust?

The dictionary defines trust as a firm reliance on the character, ability, or integrity of something.

Character. Ability. Integrity.

Over the years, we have proven the character of our industry by being open, honest, clear and concise with our shareholders about the risks and rewards of their investments. The industry, through the

Institute, conducts an aggressive investor awareness campaign to help our shareholders establish realistic expectations about mutual fund performance and to focus on long-term investment goals.

We have demonstrated the ability of the men and women of our industry to provide value to our shareholders by offering new investment opportunities to meet their increasingly specialized demands. We also have a history of offering products to meet their retirement savings needs. Keoghs, IRAs, 401(k)s and now the Roth IRA. We are an active participant in the information age with online access for information and transactions. Our fund families offer something to meet nearly every investment need.

And we have performed with integrity. I do not believe there is another industry with our reputation for adhering to high ethical standards and for adopting procedures that exceed regulatory requirements. Our industry's tradition of integrity is based on our actions.

Character. Ability. Integrity. Together, they form trust.

By placing their trust in us, our shareholders are making us a part of their plans for comfortable retirements and the education of their children. In short, our shareholders are making us an important part of their lives. And with their trust comes responsibility.

Shareholders have entrusted us with their savings in return for our pledge to provide professional management and quality service at a fair price. Each of us must demonstrate to shareholders that their trust in us is well deserved.

Trust is earned. Not given freely. Trust must never be taken for granted. For once trust is lost, it is lost forever.

Irving Berlin once was asked what he found difficult about being a success. He thought for a moment, and said: "The toughest thing about success is that you've got to keep on being a success."

The Institute has played no small role in the continued success of our shareholders by working on legislation and regulation affecting investment companies and their shareholders, by building investor knowledge, and by maintaining a tradition of integrity.

Our success is based on the character, ability, and integrity of our industry and on the trust that our shareholders have in us. We must never take this trust for granted. In this life, as Theodore Roosevelt said, "we get nothing save by effort."

As outgoing Institute Chairman, with 30 years in the investment business, I want to share a few final thoughts on the challenges and opportunities that I see in our industry's future.

First the concerns.

- We are no longer a cottage industry, as you have just heard. As a result, we are a tempting target for unrelated programs and taxes, such as Community Reinvestment Programs and other "success taxes."
- There remain major questions as to how we will be regulated in the future, and by which regulator.
- In the rapidly changing financial services industry with complex holding companies owning mutual funds, can we continue to speak with a single clear voice for our industry and our shareholders?

Greatly overshadowing these concerns are the phenomenal opportunities I see for our industry in the future. Despite our recent remarkable growth, there are still tremendous opportunities ahead.

- Federal policymakers are aware of the need to stimulate savings and investment.
- There is a growing awareness in Washington of the need for individuals to be responsible for their own retirement and for the college education of their children.
- I sense a mood in Congress for further tax cuts, perhaps a flat tax, and lower capital gains taxes.
- Far sighted public policy leaders are managing a debate on Social Security reform that may indeed address a problem responsibly and before it is a crisis. We must both continue to support a strong Social Security system founded on fiscal solvency but also encourage new ways to help people provide for their retirement. As part of this, we welcome the debate over establishing universal Personal Savings Accounts as part of the Social Security solution. The two—a sound Social Security system for those who need it and personal savings accounts—are not mutually exclusive. They can, if carefully crafted with investor protections in mind, go hand in hand.
- I see further liberalization of IRA limitations and new types of IRAs over time. I believe a pretax universal IRA is entirely possible. The universal IRA was a brilliant, simple savings vehicle that truly stimulated savings in this country. It was a great idea; it still is.
- It is also possible to see expanded coverage and liberalized contribution limits on other vehicles, such as the 401(k).
- Congress is taking steps to make our products more competitive in the global marketplace.

Just imagine our future growth and new opportunities for shareholders with some of these events being superimposed on our strong industry fundamentals and the exciting demographics ahead of us.

As many of you know, my last one-year term ends later this year. It has been my honor and privilege to serve as your Chairman for the past two years. Getting to work closely with our industry’s leaders and the outstanding staff of the Institute has been one of the most gratifying experiences of my career.

I doubt that many of you appreciate how fortunate we are to have such an outstanding association in the Institute. I know I didn’t know how well regarded the Institute was until I got very involved in it in recent years.

I continuously hear only the utmost high praise for the Institute’s staff from regulators, legislators and members of the executive branch of government. Confirming this anecdotal evidence is hard data from a recent survey evaluating the performance of the Institute by you, its members. Your evaluation of the Institute scored it at the highest level ever seen by the consultant conducting the survey in his 20 years of polling members of trade associations.

Congratulations to Matt Fink and the outstanding, capable staff he has assembled.

Aren't you proud to be a part of this association? I know I am. I hope you will continue your involvement in the Institute and I urge you to recommit to be even more active in the future. A strongly involved membership is one of the vital cornerstones of our future success.

I deeply appreciate the support of all of you and our entire membership. Thank you for the privilege of serving as your Chairman.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.